observed in this proceeding that

> [C]onsumers benefit from lower-cost products and services, as well as wider program choice. . . . Instead of making choices between channels carried exclusively by one satellite carrier or the other and then shouldering risks associated with changes in program line-ups or their own preferences down the road, customers will be able to confidently access their favorite satellite radio content.[41]

Common Cause, despite purporting to conduct a "careful analysis" of the issue, ignores key aspects of the companies' post-merger programming plans.[42] It argues that increased choice will "come at a cost" because consumers will have to pay more to get additional channels.[43] Of course, asking consumers to pay more in order to get more is hardly a revolutionary pricing concept. More importantly, however, Common Cause completely ignores the other side of the range of choices: *consumers who want less will be able to pay less.* In such cases, choice does not come at a cost—it comes at a discount.

Some parties claim that this increased choice is not a merger-specific benefit, generally asserting that "nothing prevents" the companies from providing such programming options now.[44] They are wrong. First, individually, the two companies have experienced billions of dollars in losses and, while they have made steady progress in developing their respective networks and services for over a decade, they have never turned a profit. Without the synergies and economies of scale generated by the merger, neither company could afford to introduce a la carte offerings. Moreover, offering a la carte programming requires modifications to important

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41 Hazlett at 3-4.

42 Common Cause at 42.

43 *Id.* at 43.

44 Sidak July 9 Supp. Decl. at 20 (¶ 29); *see also, e.g.*, NAB at 39-40; Common Cause at 43-44; Entravision Holdings at 17.

elements of the companies' infrastructures, including substantial changes to their subscriber management, customer service, and billing systems. In addition, even apart from the significant financial constraints, Sirius and XM cannot offer each other's programming to the extent they are bound by exclusive programming agreements or are limited by the technology in existing radios. Thus, even if the companies individually could feasibly offer comparable programming packages to those described above, consumers will obtain this benefit more rapidly and efficiently following the merger than they ever would without it—which, of course, is the relevant standard under the Commission's precedent.[45]

While Sirius and XM are providing significant new detail of their programming plans in this filing, their overall direction should come as no surprise. As noted above, the companies repeatedly have stated their intention to take full advantage of the efficiencies created by this merger to provide consumers with more programming choices and lower prices. And a diverse group of supporters—to borrow a phrase appropriate to the dynamic market for audio entertainment services—have clearly been listening. Indeed, commenters ranging from public interest groups,[46] to content providers,[47] to XM's and Sirius' commercial partners,[48] to individual consumers,[49] to many others,[50] already have responded enthusiastically to this theme of greater

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45 *See, e.g.*, *AT&T/BellSouth Order* at 5760 (¶ 200); *see also infra* Section II.E. (discussing efficiencies that will permit the introduction of a la carte and the other programming packages).

46 *See, e.g.*, Citizen Outreach Project at 1-2; Free State Foundation at 4-7.

47 *See, e.g.*, Frank Sinatra Enterprises at 1-2; New Life Ministries at 2; OutQ at 1; Steven Van Zandt at 1.

48 *See, e.g.*, Hyundai Motor America at 1-2; American Honda Motor Co. at 1; Loral Space and Communications at 1-2.

49 *See supra* notes 12-15.

choice and lower prices.

B. The Combined Company Will Be Able to Provide Increased Opportunities for a Wider Variety of Content Providers.

In addition to the obvious benefits for consumers, the combined company will be better equipped to invest in and promote diverse programming than either company is today. The merger will help to alleviate the financial constraints that may prevent the companies individually from taking chances on niche programming that, by definition, generates interest across a smaller spectrum of listeners.[51] In the longer term, the merger will increase the combined company's capacity to provide more programming because it will be able to eliminate duplicative channels and economically produce and market interoperable radios capable of receiving signals from both systems.[52]

The combined company will have every incentive to take advantage of these expanded capabilities to continue to promote diverse content[53]—something that consumers clearly want, if this proceeding is any indication. Indeed, many commenters—including content providers and their target audiences—recognize these benefits. A number of content providers have applauded

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[50] *See, e.g.*, Heritage Foundation at 3; Crutchfield at 1.

[51] Public Knowledge at 3 (stating that "a stronger merged company will allow for more diverse programming, and will ultimately improve consumer choices").

[52] *See* Application at 12-13, 47 (describing the combined company's ability to eliminate redundant channels); *see also infra* Section II.C. (discussing how the merger will eliminate disincentives to produce interoperable radios).

[53] Claims to the contrary are premised on the flawed view that satellite radio does not compete with other audio entertainment providers, *see, e.g.*, NAB at 30-32, or that the combined company will be required to drop channels, *see, e.g.*, Asian American Justice Center at 3. These assertions are rebutted *infra* Sections III and V, respectively. *See also* CRA Competitive Effects Analysis at 66-69 (¶¶ 130-137) (rebutting NAB and Common Cause claims of a satellite radio monopsony).

the prospect of reaching a wider audience as a result of the merger.[54] As the companies explained in their Application, providers of niche programming in particular stand to benefit from the increased opportunities that a combined satellite radio provider will be able to offer them.[55]

Likewise, several organizations have observed that the combined company will provide an expanded platform for news and entertainment targeted at a range of diverse communities.[56] This new, diverse programming will be available pursuant to the various programming packages

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[54] *See, e.g.*, Frank Sinatra Enterprises at 1-2 (stating that the merger will benefit consumers by making the currently exclusive program "Siriusly Sinatra" available to more listeners); New Life Ministries at 2; OutQ at 1 ("the merger will broaden the accessibility of the distinctive and valuable material offered via OutQ"); Steven Van Zandt at 1 (satellite radio "will fulfill the ever-growing number of profoundly important niches, which include nothing less than the entire musical history of American culture"). A recent article by Archbishop Edward Cardinal Egan of New York recently expressed similar views. *See* Edward Cardinal Egan, *The Good Word—Via Satellite*, NEW YORK POST, July 20, 2007, http://www.nypost.com/seven/07202007/postopinion/opedcolumnists/the_good_word___via_satellite_opedcolumnists_edward_cardinal_egan.htm (last visited July 22, 2007) ("From my perspective . . . [the merger] offers a unique opportunity to extend the reach and breadth of religious programming. It is also an unmatched opportunity to strengthen this new medium and position satellite radio to compete with the ever-growing list of audio entertainment providers.").

[55] *See* Application at 13, 47.

[56] *See, e.g.*, NAACP Letter at 2 ("[B]oth XM and Sirius offer numerous music and entertainment channels of interest to the diverse taste of African-Americans—from the smooth sounds of Motown and Jazz to contemporary R & B and Hip Hop to cutting edge urban comedy. Synergies created by the merger of Sirius and XM will create new opportunities for this type of targeted programming that is frequently overlooked by terrestrial broadcasters."); Letter from Lillian Rodriguez-Lopez, Hispanic Federation, to Marlene H. Dortch, FCC, MB Docket No. 0757, 1 (filed June 5, 2007) (stating that "satellite radio provides expanding and vibrant platforms for news and entertainment for Hispanic Americans" and that "the acquisition could help strengthen both companies and enable them to expand the universe of diverse programming available to communities across the country and provide additional channel capacity"); National Council Letter at 1 ("Expanding the audience and diversity of satellite radio programming, would give women the opportunity to open new venues of entertainment and enlightenment while driving their children to school or sitting in traffic on their way to work.").

described above, just like programming intended to reach a wider audience.[57] Thus, the merger will allow the combined company to maintain and, in fact, further the commitment to diverse programming that both companies have exhibited on their own and which is now a hallmark of satellite radio.[58]

C. The Merger Will Facilitate the Commercial Availability of Interoperable Radios.

Sirius and XM have spent much effort and resources in designing an interoperable radio.[59] However, due to current size and cost constraints of an interoperable radio, manufacturers have expressed little interest in producing or distributing such a product; nor has any automobile company opted to include one in its vehicles. And neither company has chosen to subsidize the cost of producing an interoperable radio because of uncertainty that such an expense could be recouped in the marketplace.

As the CRA Competitive Effects Analysis shows, the merger will remedy these barriers by providing a commercial incentive to produce and distribute interoperable radios.[60] Increased subscribership will likely encourage radio manufacturers to produce, consistent with customer demand, radios that tune to all channels of the combined company's service. Indeed, over the

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57 Although a few parties question whether new programming and services can or will be introduced, those doubts generally are premised on a misperception concerning the companies' ability to expand their programming capacity. As explained below, XM and Sirius have consistently employed the latest technologies to use their existing bandwidth more efficiently and thus accommodate more programming and services, and will continue to do so while preserving audio quality. *See infra* Section V.B.

58 Even a cursory review of the channel line-ups attached as Exhibits B and C shows that both companies already offer an array of programming directed at specific audiences.

59 *See infra* Section VII.A.1.

60 CRA Competitive Effects Analysis at 65 (¶ 127) ("The merger will increase the introduction and promotion of interoperable radios, leading to product quality improvements.").

long run, such radios will enable the combined company to offer enhanced content and services. Thus, the merger will enhance the availability and distribution of interoperable equipment, allowing consumers to obtain all of the content available on both systems with a single consumer device.

In short, the proposed merger will eliminate the final barriers to the commercial availability of an interoperable radio. Again, this is the very definition of a merger-specific benefit, and claims to the contrary fall flat.[61]

D. The Combined Company Will Be Able to Offer New, Advanced Services.

The same efficiencies that will allow the combined company to offer the "best of both" networks and the other programming options described above will allow it to develop and introduce advanced data and telematics services.[62] These offerings, which have undeniable value for consumers,[63] will be made available more rapidly and with greater capabilities through a

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61 Some parties allege otherwise, based on the incorrect theory that the *production* of interoperable radios is already required by Commission rules. *See, e.g.*, NAB at 45. As discussed below, neither the Commission's rules nor the companies' licenses contain such a requirement, and the companies have complied fully with their actual obligations pertaining to interoperability by jointly designing an interoperable radio such that it is available for manufacturers to produce. *See infra* Section VII.A.1. The merger will allow them—and consumers—to reap the rewards from that design.

62 *See* Application at 14-15. For example, Sirius and Chrysler Group recently announced the launch of SIRIUS Backseat TV™, a dynamic and pioneering TV service that delivers live television to vehicles. This new service will provide customers with three channels of children's TV including Nickelodeon, Disney Channel and Cartoon Network. Both XM and Sirius offer integrated traffic and navigation systems for automobiles (XM NavTraffic and Sirius Traffic), as well as weather and navigation products for the aviation and maritime markets (XM WX and Sirius Marine Weather).

63 *See, e.g.*, Letter from Phil Boyer, Aircraft Owners and Pilots Association, to Marlene H. Dortch, FCC, MB Docket No. 07-57 (filed July 9, 2007) (describing the importance of weather services provided over satellite, and stating, "Without a doubt, satellite radio improves safety for aviation."); Hyundai Motor at 1-2 ("the merged company will likely improve upon current in-

combined research and development effort—an effort that will continue to develop technologies and services without harm to the audio quality currently available to satellite radio customers.[64] Although several parties suggest conditions to govern the combined company's provision of these types of services,[65] the combined company will have every incentive to maintain and improve upon these offerings without any need for Commission action.

This consolidation of resources will also enhance the merged company's ability to provide emergency alert and other emergency services. The dedication that each company already has shown to public safety and homeland security extends well beyond broadcasting national Emergency Alert Systems ("EAS") messages and testing EAS procedures and equipment as the Commission requires.[66] Sirius and XM have shown their commitment to aid disaster victims and rescuers on an ongoing basis respectively through Sirius Channel 184, which provides around-the-clock, up-to-date emergency information regarding catastrophic events to most Sirius radios regardless of subscription status, and XM Emergency Alert (XM Channel 247), which delivers such information free to all XM receivers nationwide, with no subscription required. Both companies also have aired extensive on-air fundraising appeals to listeners, such as XM's Operation Helping Hand and Sirius' charity radiothon for Hurricane Katrina victims. In addition, XM aired "Tsunami Aid: A Concert of Hope," to benefit victims of the 2004 tsunami in southern Asia. Moreover, the Federal Emergency Management Agency ("FEMA") recently

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vehicle services that support the driving experience, such as traffic and weather, and promote the introduction of exciting new services").

64 *See, e.g.*, Merrill Lynch, 3 (Feb. 20, 2007); Bear Stearns, 5 (Mar. 22, 2007).

65 *See, e.g.*, Rockwell Collins at 2.

66 47 C.F.R. §§ 11.1, 11.11 (2005) (as amended, 70 Fed. Reg. 71,023, 71,031 (Nov. 25, 2005)).

notified XM that it has been designated a Tier 3 EAS PEP Station, meaning that XM is now a Primary Entry Point with a direct link to FEMA. Finally, FEMA is installing XM's EAS receivers in state Emergency Operation Centers, which further highlights XM's critical role with respect to the EAS system and the distribution of emergency alerts.

Further, both companies have worked with the Commission, the Department of Homeland Security, and other federal and local agencies to develop and implement effective programs to distribute safety and survival information.[67] These officials have recognized the importance of satellite-based communications systems during natural disasters and other emergencies.[68] Satellite radio can continue to provide emergency information such as evacuation routes and other critical safety information even when terrestrial-based systems are impaired, and the merger will only enhance that role.

E. <u>The Transaction Will Produce Significant Efficiencies and Will Safeguard the Future of Satellite Radio.</u>

In evaluating the Application, the Commission's primary task is to determine whether the merger will serve the public interest.[69] The Commission has recognized that identifying potential "[e]fficiencies generated through a merger" is a critical aspect of this analysis because

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67 For example, as discussed in the Application, during the Hurricane Katrina relief effort, Sirius broadcast 24/7 news and information while XM broadcast Red Cross Radio, which supplied critical information to victims and Red Cross relief workers. Both operators donated hundreds of satellite radios to rescue workers and shelters to ensure that they could access this information. *See* Application at 5, 14.

68 *See, e.g.*, *Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services*, Statement of Comm'r. Tate, FCC 07-34 (Mar. 26, 2007) (citing the "critical importance of satellite communications for emergency first responders" in the wake of Hurricanes Katrina, Rita, and Wilma).

69 *See* 47 U.S.C. § 310(d) (2000) ("No . . . station license, or any rights thereunder, shall be transferred . . . to any person . . . except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby.").

such efficiencies may "result in lower prices, improved quality, enhanced service or new products," which, in turn, would increase consumer welfare if those benefits offset any competitive harms.[70] The combination of Sirius and XM will produce considerable merger-specific efficiencies, leading to more innovative services for consumers, higher quality services, and lower prices—to the benefit of consumers. Without the merger, consumers will not realize these benefits.

Independent analysts have overwhelmingly agreed that the merger will produce considerable, merger-specific cost savings, in both the short- and long-term. For instance, UBS Investment Research observed that opportunities from the merger "could represent approximately $205 million in potential savings" in the near term, while long-term cost synergies are likely to be in the range of $3 to 4.7 billion.[71] Merrill Lynch observed that there could be "annual cost synergies of ~$400mm in the near term,"[72] and estimated cost synergies over 10 years to amount to $4.3 billion.[73] And Professor Hazlett agrees that consumers will benefit directly from "lower cost products and wider customer choice" as a result of, among other things, "greater scale economies in radio receivers and standardized technologies."[74] He also concludes that the newly formed entity will stimulate competition in the market for audio entertainment services, and will turn toward "innovation and product upgrades" that would be

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70 *NYNEX/Bell Atlantic Order*, 12 FCC Rcd at 20,063 (¶ 158); *see also SBC/Ameritech Order*, 14 FCC Rcd at 14,847 (¶¶ 319-20).

71 UBS, 2 (Feb. 20, 2007).

72 Merrill Lynch, 1 (Feb. 20, 2007).

73 *Id.* at 3.

74 Hazlett at 13.

"otherwise unaffordable," thereby causing other providers to do the same.[75]

The companies also have concluded that the merger is likely to produce considerable, merger-specific savings that will benefit consumers. Sirius and XM have identified areas where duplicate expenses can be eliminated, scale economies can be achieved, and where other cost and revenue synergies exist in a merged company.[76] As discussed in the Declaration of David Frear, Executive Vice President and Chief Financial Officer of Sirius,[77] significant merger-specific savings are likely to result in the following areas:

- *Satellite Operations.* In the nearer term, the combined entity will be able to eliminate significant redundancy in satellite uplink, control, and transmission facilities, including reducing costs necessary to communicate with satellites, as well as the costs of duplicative back-up control facilities. Over the longer term, capital expenditure savings in satellite network replacement will be substantial.[78]
- *Broadcast Operations.* The combined company can eliminate duplicative studio operating costs, including personnel, facilities, content storage and retrieval, and content delivery costs. The costs associated with webstreaming can also be rationalized post-merger.[79]
- *Terrestrial Networks.* Duplicative costs to operate and maintain terrestrial repeaters could be eliminated or reduced through the co-location of terrestrial

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75 *Id.*

76 Because of legal requirements limiting the types of information that the management of either standalone company can review regarding the other's operations, Sirius and XM have retained outside consultants for the purpose of reviewing the operations and financials of both companies and quantifying, based on the consultants' expertise, the potential efficiencies of the proposed merger. The quantification of these synergies is an on-going process, and because much of the information is commercially sensitive and proprietary, Sirius and XM will provide additional information to the FCC subject to a heightened Commission protective order limiting access to that information to the Commission and third parties' outside counsel and outside consultants.

77 Declaration of David Frear, Executive Vice President and Chief Financial Officer, Sirius Satellite Radio Inc., Exhibit D (July 23, 2007) ("Frear Decl.").

78 *Id.* at 3 (¶ 6).

79 *Id.* at 3 (¶ 7).

repeater sites. Further, incremental costs incurred to identify and build out new terrestrial repeater sites can be reduced by installing and co-locating new equipment at existing satellite radio repeater sites.[80]

- *Programming and Content.* The merged entity will generate significant merger-specific efficiencies by eliminating duplication in the overhead and production of similarly formatted channels and by improving scale economies in content acquisition. Moreover, satellite radio will become a more compelling distribution outlet because the combined firm will allow content producers to reach a larger audience than is currently possible. The combined entity should achieve considerable variable and fixed-cost savings in connection with contracts with providers for duplicative content.[81]
- *Customer Service and Billing.* Customer service and billing efficiencies can be achieved through economies of scale in call center service procurement, and in customer care and retention-specific telecommunication and information technology costs.[82]
- *Sales and Marketing.* Substantial fixed and variable cost savings are expected from the elimination of duplicative marketing expenses and through the benefits ensued to retail and OEM distribution partners that would otherwise be unattainable.[83]
    - *Marketing.* Marketing efficiencies will arise from the rationalization of duplicative headcount and related expenses, and the improved ability of the combined company to promote satellite radio against other audio entertainment alternatives. The marketing efforts of the merged firm will be more effective as the combined entity internalizes the existing "spill-over" effect (phenomenon whereby each standalone company benefits from the promotional efforts of the other, but neither is able to capture all the benefits of substantial marketing expenditures) allowing the firms to engage in more effective advertising aimed at expanding the satellite radio category.[84] In addition, the combined entity will achieve savings in promotions, website development, and advertising buys.
    - *Retail Distribution.* Substantial duplication exists across the companies' retail marketing organizations given coverage of the same retailers, presenting an opportunity for headcount rationalization. The merged

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80 *Id.* at 4 (¶ 8).

81 *Id.* at 4 (¶¶ 9-10).

82 *Id.* at 5 (¶ 11).

83 *Id.* at 5-6 (¶ 12).

84 *See infra* at 31-32.

company can also offer an improved value proposition to retailers and distributors potentially resulting in variable cost savings in retail distribution which can lead to lower equipment prices for consumers. The combined firm will drive higher sales volume per square foot through the availability of better and more innovative products on retail floors. Further, promotion of a single satellite radio brand/service will free up in-store and advertising circular space, while also reducing retailers' promotional spending requirements for the satellite radio category.

- *OEM Distribution.* The merged company will also offer an improved value proposition to its automakers. As conversion and retention rates increase over time through enhanced programming choices (*e.g.*, packages and a la carte offerings, coupled with the availability of previously exclusive content such as Oprah Winfrey for Chrysler and Ford vehicle owners), OEMs will experience an overall revenue share lift from a larger satellite radio subscriber base, further motivating automakers to install and market satellite radio.
- *OEM Contracts.* If the new combined offerings provide the company and its OEMs additional value through improvements in churn, conversion rate, revenue share and customer satisfaction, it is likely that contract term negotiations will result in improved economics and reduced variable costs for the combined company.

- *Subscriber Acquisition Costs.* Among other efficiencies in the supply chain, the combined company would be able to achieve cost savings by streamlining product offerings through the elimination of identical or similar devices and accessories, and by achieving economies of scale in sourcing materials and chip sets, and in absorbing manufacturing overhead and shipping costs.[85] These efficiencies will result in lower subscriber acquisition costs per gross OEM and retail subscriber added by the combined company.
- *General and Administrative.* The merged company will be able to eliminate duplicative executive management costs, reduce insurance costs, and eliminate overlap in legal, investor relations, external accounting and auditing costs. Additional efficiencies will be realized from more traditional business expenses such as office supplies.[86]
- *Product Development.* The merged entity would be able to draw from the best of the two product development efforts, accelerating the introduction of new and improved satellite radio receivers, services and chipsets. The combined company will also be able to achieve significant cost savings by eliminating duplicative

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[85] Frear Decl. at 6 (¶ 13).

[86] *Id.* at 6-7 (¶ 14).

efforts and personnel.[87]

- *Depreciation Costs.* The combined company would reduce future depreciation costs as it realizes significant capital expenditure efficiencies related to satellite expenditures, leasehold improvements, IT equipment, and other capital costs.[88]
- *Interest Expense.* The combined company will have superior credit quality and will, therefore, lower its borrowing costs.[89]

In addition to realizing these cost-savings, the combined company will experience synergies and efficiencies that result in increased revenues:

- *Subscriber Revenue.* By introducing a la carte and new programming packages, and by the availability of previously exclusive content, the combined entity will be able to attract more subscribers, reduce churn, and increase conversion rates among OEM subscribers. The result will be an increase in the subscriber base and revenue.[90]
- *Ad Revenue.* The combined company will be able to receive greater revenue from advertising as a result of offering advertisers broader reach, and therefore a more attractive and targeted audience.[91]
- *Equipment Revenue.* The combined company will be able to compete more effectively for consumer attention in online marketing and retail sales, resulting in increased revenue from the sale of subscriptions and equipment.[92]

The companies also expect that the merged company will simultaneously be able to improve satellite radio penetration and expand consumer choice and quality. Furthermore, the efficiencies that the companies have identified are expected to lead to increased output, or lower quality-adjusted prices. As discussed above, offerings that will be available post-merger include: (i) new service packages, (ii) additional and more diverse content, and (iii) devices with greater

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87 *Id.* at 7 (¶ 15).

88 *Id.* at 7 (¶ 16).

89 *Id.* at 8 (¶ 18).

90 *Id.* at 8-9 (¶¶ 19-23).

91 *Id.* at 9 (¶ 24).

92 *Id.* at 10 (¶ 25).

functionality at lower prices.

Opponents of the merger dispute that the transaction is likely to produce these merger-specific efficiencies and the attendant consumer benefits, such as lower prices and greater innovation, but they fail to engage the facts or the underlying economic analysis. For instance, the NAB argues that "XM and Sirius could offer lower-priced packages with fewer channels now,"[93] and it insists that the availability of more content is not merger-specific because "[t]he companies did not have to enter into exclusive contracts for programming; they chose to do so."[94] Such claims entirely ignore business and economic realities. The two companies would have neither the ability nor the economic incentive to exchange content to create a la carte offerings. Sirius and XM have invested over $5 billion each in their respective businesses overall, and continue to report significant operating losses—indeed, neither company has yet to achieve free cash flow or earn a profit. In 2006, the two companies incurred total costs of approximately $3.4 billion, much of which is attributed to the cost of acquiring new subscribers. It is completely unrealistic for the NAB to suggest that, even without the merger, it is financially feasible for Sirius and XM to offer these additional benefits to consumers. The facts clearly demonstrate that the combination of Sirius and XM will generate sizeable efficiencies that simply cannot be achieved in the absence of a merger—efficiencies that will be passed along to consumers in the form of greater choice and lower quality-adjusted price.[95]

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[93] NAB at 37.

[94] *Id.* at 39.

[95] *See* Fed. Trade Comm'n & Dep't of Justice, *Commentary on the Horizontal Merger Guidelines*, at 50 (2006) ("*FTC/DOJ Commentary*") ("Economic analysis teaches that price reductions are expected when efficiencies reduce the merged firm's marginal costs, *i.e.*, costs

Satellite radio is still at a nascent stage of its life cycle and faces ever-intensifying competition from other audio entertainment services. Under these circumstances, both Sirius and XM have a strong incentive to engage in penetration pricing (*i.e.*, offer a relatively low initial entry price) and offer attractive content in order to expand their subscriber base and popularize their particular satellite radio services, with an eye toward long term profitability.[96] These dynamics largely explain why both companies have invested substantial amounts of capital to create demand for satellite radio, and have had to relinquish a substantial share of the value of each incremental customer to device manufacturers and distributors.

In the absence of the merger, each company is unable to capture all of the benefits of its long-term strategy because each satellite radio company is able to benefit from the promotional efforts of the other.[97] CRA identifies the economic conditions that give rise to this "dynamic demand spillover effect" and explains that it "generates a free-rider problem between Sirius and XM. Lower prices charged by XM also would increase the number of Sirius subscribers, and vice versa."[98] These dynamics may motivate Sirius and XM to "over-invest in brand-specific

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associated with producing one additional unit of each of its products."). Variable cost is simply the sum of marginal costs.

96 *See, e.g.*, Statement of Mel Karmazin, CEO, Sirius, *Final Transcript, SIRI—Q1 2005 Sirius Satellite Radio Earnings Conference Call*, Thomson StreetEvent, Apr. 28, 2005, at 11 ("What our focus today is on growing the category. It is a relatively small number of people that are currently subscribing to satellite radio. We want that number to grow huge, and we think that being attractively priced at retail, providing great content at good value is the way we grow the market.") (quoted in CRA Competitive Effects Analysis at 44, n.168 (¶ 77)); *see also* CRA Competitive Effects Analysis at 47 (¶ 83) ("Pricing and other marketing strategies of XM and Sirius are consistent with this longer-run focus and the penetration pricing strategy.").

97 CRA provides an extensive discussion of this problem in its economic analysis of the proposed merger. CRA Competitive Effects Analysis at 46-48 (¶¶ 81-86).

98 *Id.* at 47 (¶ 85).

advertising and under-invest in generic advertising."[99] In other words, this "dynamic demand spillover effect" artificially inflates certain investments (such as branding) that allow one satellite radio company to achieve greater penetration relative to the other company, in an effort to counteract (or at least mitigate) the effects.

The combined company will resolve this problem by "allowing the merged firm to obtain *all* the incremental satellite radio subscriptions generated by its low prices and other investment efforts."[100] This means that the merged entity "will have an increased incentive to undertake demand-enhancing investments, including penetration pricing"[101] and further "to reduce its variable costs."[102] This efficiency is clearly merger-specific because, without the merger, it is infeasible for these companies to reach a coordinated solution (and such coordination would, in any event, prompt allegations of anti-competitive behavior under Section 1 of the Sherman Act).[103]

Much of the anticipated efficiencies constitute variable-cost savings, but there are also cognizable fixed-cost savings that will directly translate into increased consumer welfare. For instance, as noted, the combined company will be able to eliminate redundancies in product and chipset design, facilitating the development of "next generation" products and the introduction of new services, such as advanced data and telematics services. The NAB contends that these benefits are not merger-specific because "nothing currently prevents the companies from

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99 *Id.* at 62 n.224 (¶ 119).

100 *Id.* at 61 (¶ 117).

101 *Id.*

102 *Id.* at 63 (¶ 120).

103 15 U.S.C. § 1 (prohibiting all unreasonable restraints of trade).

working together to develop 'common engineering standards and protocols,'" and it urges the Commission to ignore these efficiencies because they involve fixed, rather than variable, costs.[104] Both of these arguments lack merit.

First, the NAB's suggestion that the companies could achieve the same efficiencies by jointly developing innovative products or services is incorrect. As CRA observes, that approach is not practically feasible because it would require the more innovative firm to cede a potential comparative advantage, would involve significant coordination issues between the two companies, and would ultimately be less effective at producing the efficiencies expected from the merger.[105] Moreover, the sharing of innovation, as with the sharing of content, "would lead to classic promotional free-riding problems."[106] Indeed, the FCC, FTC, and DOJ have recognized that joint ventures or contracts are often not "practically feasible or impose substantial transaction costs (including monitoring costs)," and therefore an efficiency should not be disqualified from the analysis merely because it "theoretically could be achieved without a merger—for example, through a joint venture or contract."[107]

Second, the NAB is simply incorrect that only marginal costs matter in a merger analysis. The FTC/DOJ Horizontal Merger Guidelines explain that "[c]ognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in

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104 NAB at 42-43.

105 CRA Competitive Effects Analysis at 63 (¶ 122).

106 *Id.* at 65 (¶ 126).

107 *FTC/DOJ Commentary* at 50. *See also AT&T/BellSouth Order*, 22 FCC Rcd at 5762 (¶ 205) (acknowledging the "well-recognized inefficiencies" of joint ventures).

output or service."[108] As CRA correctly observes, some of the fixed-cost savings that will result from this merger "involve increases in the efficiency of advertising and other demand-enhancing expenditures" that will provide the merged firm with adequate "incentive to increase competition and output."[109] Other fixed-cost savings "will increase the likelihood that the merged firm will remain viable in the longer-run and maintain longer term investment incentives. These fixed cost savings all would be treated as cognizable under the current merger enforcement policy."[110]

As noted above, significant portions of these fixed- and variable-cost savings will be shared with customers through lower prices and improved service offerings. The Commission has repeatedly acknowledged that lower prices and increased consumer choice are cognizable public interest benefits that would support a merger if they outweigh any adverse effects.[111] The evidence clearly demonstrates that the efficiencies generated by the transaction will outweigh the competitive harms (if any), and the public will benefit. The opponents of the merger have failed to establish any legitimate ground—either factual or economic—that would explain why this merger should not be permitted.

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108 Fed. Trade Comm'n and Dep't of Justice, *Horizontal Merger Guidelines* at § 4 (Apr. 8, 1997) ("Horizontal Merger Guidelines").

109 CRA Competitive Effects Analysis at 64 (¶ 123).

110 *Id.* (citing *FTC/DOJ Commentary* at 58 ("The Agencies consider merger-specific, cognizable reductions in fixed costs, even if they cannot be expected to result in direct, short-term, procompetitive price effects because consumers may benefit from them over the longer term even if not immediately.")).

111 *See, e.g.*, *Adelphia/Time Warner Order*, 21 FCC Rcd at 8307 (¶ 23); *NYNEX/Bell Atlantic Order*, 12 FCC Rcd at 30,063 (¶ 158) ("Efficiencies generated through a merger can mitigate competitive harms if such efficiencies . . . result in lower prices, improved quality, enhanced service or new products."); *MCI/BT Order*, 12 FCC Rcd at 15,430 (¶ 205) (describing "lower prices, improved quality, enhanced service or new products" as examples of consumer benefits resulting from merger-specific efficiencies that are relevant to the public interest analysis) (citation and quotation omitted).

III. THE RECORD DEVELOPED IN THIS PROCEEDING CLEARLY DEMONSTRATES THAT THIS IS NOT A "MERGER TO MONOPOLY."

Nearly all of the opposing commenters reflexively argue that the proposed transaction constitutes a "merger to monopoly."[112] If this were true, the evidence would reveal that the two companies combined would have the ability and incentive to raise quality-adjusted prices or decrease output—or, put differently, the anticipated competitive harm to consumers would outweigh the benefits. But the facts show precisely the opposite. As shown in the preceding section, the merger will generate many benefits that the companies alone would not be able to achieve, and Section IV, *infra*, explains why the opponents' predictions of competitive harm are very unlikely to come to pass.

This section explains why the assumption underlying the well-worn refrain of "merger to monopoly"—that Sirius and XM compete in a market comprised only of these two companies—is demonstrably false. In delineating the outer boundaries of the relevant market, the key is to identify all products that are reasonable substitutes for the product at issue.[113] All available evidence demonstrates that consumers have an abundance of reasonable substitutes for satellite radio, including most directly terrestrial radio and HD Radio, as well as wireless phones, iPods and other MP3 players, and Internet radio—and consumer choices are rapidly increasing over time. All these forms of audio entertainment shape the competitive landscape and constrain the ability of the combined company to raise prices or restrict output.

The market definition analysis, properly applied, clearly disproves the claim of a

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112 *See, e.g.*, Sidak July 9 Supp. Decl. at 3 (¶ 1); NAB at 23-26; Common Cause at 1.

113 *See, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *Adelphia/Time Warner Order*, 21 FCC Rcd at 8234 (¶ 59); *Applications of AT&T Wireless Inc. and Cingular Wireless Corp. for Consent to Transfer Control*, Memorandum Opinion and Order, 19 FCC Rcd 21,522, 21,552 (¶ 57) (2004).

"satellite radio-only" market and shows that satellite radio commands nowhere near the market share necessary to demand higher-than-competitive prices. In going through the exercise of evaluating the opponents' market definition (and the accompanying market share analysis), however, it is critical not to lose the forest for the trees. Market definition and market share are convenient analytical tools for assessing competitiveness, but as Professor Hazlett correctly notes, "[a]rguments as to the relevant market and its competitiveness are secondary" to the question "whether a given transaction will benefit consumers and the economy."[114] Here, there is ample evidence that sizeable merger-specific efficiencies will lead directly to more choices and lower prices for consumers, with little if any offsetting competitive harm.[115] This evidence confirms that Sirius and XM are not duopolists now and that the combination of these companies will not produce a "merger to monopoly."

A. Sirius and XM Compete with a Broad Array of Audio Entertainment Services.

The Commission's review of potential competitive harms ordinarily begins with determining the appropriate product market in which the merging firms' products compete.[116] This exercise provides the Commission with an initial framework to evaluate the likely competitive effects of the proposed transaction. Here, the record plainly demonstrates that the merger will lead to many competitive benefits that outweigh any harms, under any reasonable

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[114] Hazlett at 13. *See also id.* at 12 ("The determinative policy cut is *whether the proposed merger will likely increase or decrease the value of services available to consumers.*").

[115] *See FTC/DOJ Commentary* at 10 ("In some investigations, before having determined the relevant market boundaries, the Agencies will have evidence that more directly answers the 'ultimate inquiry in merger analysis,' *i.e.*, 'whether the merger is likely to create or enhance market power or facilitate its exercise.'") (quoting Horizontal Merger Guidelines at § 0.2).

[116] Application at 21.

understanding of the market. The evidence shows exactly what the anecdotal comments of actual satellite radio subscribers suggest:[117] Satellite radio competes with and is substitutable for numerous other audio entertainment services and devices. This is particularly true for terrestrial radio, but it is clear that satellite radio also competes with Internet radio, iPods, MP3 players, wireless phones, and HD Radio. Commenters' allegations and arguments to the contrary are inaccurate, internally inconsistent, and ignore market reality.[118]

There already exists substantial substitution among satellite radio and various other audio services and devices—and particularly between satellite radio and terrestrial radio. Recent studies performed by both Sirius and XM demonstrate that when people activate a satellite radio subscription, they substitute satellite radio programming for other audio entertainment to which they historically listened. As CRA found:

> [[REDACTED [redacted]
>
> [redacted]

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[117] *See, e.g.*, Brief Comments of Alan Simmons (filed June 15, 2007) (stating that podcasts and Internet radio are "interchangeable" with satellite radio); Brief Comments of Christopher Modiano (filed May 18, 2007) (stating that he is going to cancel his satellite radio subscription and "get an iPhone and switch over to podcasts and online radio"); Brief Comments of David W. FitzGerald (filed June 19, 2007) ("the technology DOES NOT define the market; this is just aural media delivery and it is served by iPods, iPhones, MP3 Players, AM, FM, HDFM, Internet Radio, CD Players, cell phones, and etc. all in fierce battle for my ears.").

[118] *See, e.g.*, NAB at 13-17; Common Cause at 16-35.

[redacted][119]]]

The CRA Competitive Effects Analysis identifies the various substitutes for satellite radio, including terrestrial radio, wireless phones, iPods and other MP3 players, and the countless new products that are surfacing in the near term.[120] It carefully evaluates the evidence of substitution with respect to each of these alternatives, and concludes that "the proper relevant market is audio entertainment products, not satellite radio alone."[121]

<u>Satellite subscribers who deactivate service more often than not return to terrestrial radio.</u> CRA's research confirms that only a small percentage of existing subscribers switch from one satellite radio service to the other service, while there has been substantial substitution from satellite radio to terrestrial radio.

[[REDACTED [redacted][122]]]

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[119] CRA Competitive Effects Analysis at 12-13 (¶ 22) [redacted]

[120] *Id.* at 17-29 (¶¶ 30-47).

[121] *Id.* at 48 (¶ 87).

[122] *Id.* at 13 (¶ 23) [redacted]

This substitutability will grow over the next several years as terrestrial radio, wireless audio services, HD Radio, and other audio entertainment services continue to evolve.[123]

The relationship between satellite radio penetration and terrestrial radio coverage provides clear evidence of substitution between satellite and terrestrial radio. As the American Antitrust Institute ("AAI") correctly stated:

> A degree of cross elasticity might be shown if the rate of satellite radio subscriptions is higher in markets with fewer terrestrial radio stations. On the other hand, if the rate of satellite subscriptions is geographically uniform throughout the country, this would tend to indicate little cross elasticity.[124]

CRA performed this exact analysis. CRA found

> [A] clear, relatively smooth inverse relationship between average satellite radio penetration and the number of AM/FM radio stations received. Satellite radio penetration generally is higher in geographic areas where there are fewer AM/FM stations. The inverse relationship between satellite radio penetration and AM/FM coverage [[REDACTED [redacted]]] Average satellite radio penetration falls [[REDACTED [redacted]]] in [Zip Code Tabulation Areas, or "ZCTAs"] receiving zero AM/FM stations, [[REDACTED [redacted]]] in ZCTAs receiving two AM/FM stations. Average satellite radio penetration [[REDACTED [redacted]]][125]

Substitutability is further demonstrated by intermodal competitive responses—how terrestrial radio, satellite radio, and other services have responded to the introduction and evolution of other audio entertainment options. Again, the evidence is clear that "firms operating in one format have responded directly to competition from developments in other modes by

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123 *Id.* at 27-29 (¶¶ 43-47).

124 AAI at 21, n.68.

125 CRA Competitive Effects Analysis at 15 (¶ 27). The claim of some opponents that the merger will harm rural consumers is incorrect, for the reasons discussed below in Section IV.C. In fact, the transaction will bring the same tremendous benefits to rural consumers, which is why rural groups have shown overwhelming support for the merger.

rapidly adding new products and repositioning the products they sell."[126]

- Satellite radio obviously responded to terrestrial radio's primary mode of delivery by paying automakers to install their radios in cars alongside ubiquitous AM/FM radios and also paid for premium content, such as play-by-play sports, historically heard on terrestrial radio.[127]

- Terrestrial radio has responded to competition from satellite radio by reducing, nationwide, the number and length of commercials, developing HD Radio[128] (which will soon be able to be offered on a subscription basis[129]), and offering a wider variety of music.[130] In addition to these dramatic changes in their overall strategy, terrestrial radio broadcasters are also experimenting with other formats that they believe might retain more listeners. For example:

  - Clear Channel recently announced that it will no longer run traditional advertisements on one of its stations.[131] Instead, advertisers can sponsor an hour of programming during which the on-air personalities will promote the product conversationally.

  - Clear Channel is experimenting with a new type of advertisement it calls "blinks."[132] These two-second ads pop up in between songs and in the middle of

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126 *Id.* at 16 (¶ 29).

127 *Id.* at 32 (¶ 53).

128 *See, e.g.*, ABI Research, *HD Radio Could Cure US Broadcasters' Satellite Radio Woes*, May 22, 2006, http://www.abiresearch.com/abiprdisplay.jsp?pressid=651 (last visited July 20, 2007).

129 *See* CRA Competitive Effects Analysis at 20 (¶ 34) (citing Bear Sterns (June 29, 2007); *Digital Audio Broad. Sys. and Their Impact on the Terrestrial Radio Broad. Svc.*, Second Report and Order, First Order on Reconsideration and Second Further Notice of Proposed Rulemaking, FCC 07-33, ¶ 49 (May 31, 2007) ("*Digital Audio Broad. Sys. Order*").

130 *Id.* at 19 (¶ 32).

131 *See* Andrew Adam Newman, *In Dallas, Commercial Radio Without Commercials*, N.Y. TIMES, Apr. 23, 2007, http://www.nytimes.com/2007/04/23/business/media/23radio.html?ex=1183089600&en=494d05d7f82ad664&ei=5070 (last visited July 22, 2007).

132 Paul Farhi, *And Now For A Syllable From Our Sponsor, The New Radio Spots Shrinking Into Freckles*, WASHINGTON POST, June 17, 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/06/16/AR2007061601296.html (last visited July 22, 2007).

programs and simply say something like "Iced coffee at McDonald's." These new advertising models competitively respond to satellite radio's commercial-free programming.

- The HD Digital Radio Alliance, a consortium that includes many of the largest terrestrial radio companies,[133] has coordinated the rollout of HD Radio throughout the United States. There are now more than 1350 HD Radio stations, covering over 82 percent of the U.S. population.[134] One of the express purposes for the Alliance is to "coordinat[e] the formats on new multicast channels known as HD2."[135] Through these joint efforts, the HD Radio Alliance has introduced a wider variety of genres and programming offerings compared to what is currently available on traditional broadcast radio.[136] The terrestrial broadcasters also have combined forces to mount an aggressive advertising campaign to promote HD Radio rather than satellite radio. In 2005, the NAB ran an advertising campaign with the slogan, "Radio: You shouldn't have to pay for it."[137] And in 2007, the Alliance committed $250 million to promote HD Radio— [[REDACTED [redacted]]][138]

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133 The HD Radio Alliance includes ABC Radio Networks, Beasley Broadcast Group, Inc., Bonneville International, CBS Radio, Citadel Broadcasting Corporation, Clear Channel, Cumulus, Emmis Communications, Entercom, and Greater Media, Inc. *See* HD Radio.com, *HD Digital Radio Alliance Members*, http://www.hdradio.com/press_room.php#alliancemembers (last visited July 21, 2007).

134 CRA Competitive Effects Analysis at 19 (¶ 32).

135 Press Release, HD Radio Alliance, *Unprecedented Radio-Industry Alliance Will Advance Rollout of HD Digital Radio* (Dec. 6, 2005), http://www.hdradio.com/press_room.php?newscontent=16 (last visited July 21, 2007). As one analyst observed, "[f]ear of satellite radio is prompting an unprecedented level of cooperation among broadcasters in their efforts to launch HD Radio and HD2." ABI Research, *HD Radio Could Cure US Broadcasters' Satellite Radio Woes*, May 22, 2006, http://www.abiresearch.com/abiprdisplay.jsp?pressid=651 (last visited July 20, 2007) (quoting Frank Viquez).

136 Some of the genres available on HD Radio reportedly include: "Viva La Voce (opera), Classical Alternative, Traditional Jazz & Blues, Coffee House, Female Talk, Future Country, Extreme Hip Hop, and in-depth news." FMQB, *HD Digital Radio Alliance Launches 264 New Channels*, Jan. 18, 2006, http://fmqb.com/Article.asp?id=165202 (last visited July 21, 2007).

137 Press Release, NAB, *Radio Industry Launches New On-Air Ad Campaign* (Nov. 30, 2005), http://www.nab.org/AM/Template.cfm?Section=Press_Releases1&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=5170 (last visited July 21, 2007).

138 CRA Competitive Effects Analysis at 19 (¶ 32).